

**Letter of Findings Number: 03-20110079**  
**Withholding Tax**  
**For Tax Years 2007-2009**

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**ISSUE**

**I. Withholding Tax—Independent Contractors.**

**Authority:** IC § 6-3-4-8; IC § 6-8.1-5-1; [45 IAC 3.1-1-97](#); Rev. Rul. 87-41, 1987-1 C.B. 296; <http://www.irs.gov/businesses/small/article/0,,id=99921,00.html> (last accessed July 8, 2011).

Taxpayer protests the assessment of withholding tax on payments to various individuals for services performed for Taxpayer.

**STATEMENT OF FACTS**

Taxpayer is an engineering and drafting company doing business in Indiana. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer should have withheld tax on amounts it paid to various individuals who performed services for Taxpayer. The Department therefore issued proposed assessments for withholding tax. Taxpayer protests the imposition of these proposed assessments. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as necessary.

**I. Withholding Tax—Independent Contractors.**

**DISCUSSION**

Taxpayer protests the imposition of withholding tax. Taxpayer states that several people who worked for Taxpayer were in fact independent contractors who were not employees and did not receive salaries. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

The withholding tax is imposed under IC § 6-3-4-8(a), which (as in effect during the audit period) stated: Except as provided in subsection (d) or (l), every employer making payments of wages subject to tax under this article, regardless of the place where such payment is made, who is required under the provisions of the Internal Revenue Code to withhold, collect, and pay over income tax on wages paid by such employer to such employee, shall, at the time of payment of such wages, deduct and retain therefrom the amount prescribed in withholding instructions issued by the department. The department shall base its withholding instructions on the adjusted gross income tax rate for persons, on the total rates of any income taxes that the taxpayer is subject to under [IC 6-3.5](#), and on the total amount of exclusions the taxpayer is entitled to under [IC 6-3-1-3.5\(a\)\(3\)](#) and [IC 6-3-1-3.5\(a\)\(4\)](#). Such employer making payments of any wages:

- (1) shall be liable to the state of Indiana for the payment of the tax required to be deducted and withheld under this section and shall not be liable to any individual for the amount deducted from the individual's wages and paid over in compliance or intended compliance with this section; and
- (2) shall make return of and payment to the department monthly of the amount of tax which under this article and [IC 6-3.5](#) the employer is required to withhold.

In addition, the Department refers to [45 IAC 3.1-1-97](#), which states in relevant part:

Employers who make payments of wages subject to the Adjusted Gross Income Tax Act, and who are required to withhold Federal taxes pursuant to the Internal Revenue Code (USC Title 26), are required to withhold from employees' wages Adjusted Gross and County Adjusted Gross Income Tax.

....

The Internal Revenue Service has issued guidance on whether an individual is an employee or an independent contractor. Rev. Rul. 87-41, 1987-1 C.B. 296; see also <http://www.irs.gov/businesses/small/article/0,,id=99921,00.html> (last accessed July 8, 2011) (the "IRS Website"). The IRS Website provides for three categories of facts to be considered: Behavioral, Financial, and Type of Relationship.

During the audit, Taxpayer told the Department that it considered the various individuals to be independent contractors and not employees. Taxpayer stated that the individuals received federal form 1099s rather than W-2s. Taxpayer provided these forms and provided tax returns for many of the individuals showing that the individuals had reported the income and paid federal self-employment taxes.

At hearing, Taxpayer again protested that the individuals in question were independent contractors and not employees. Taxpayer provided additional explanation of the working arrangements between Taxpayer and the individuals. For each individual, the number corresponds to their listing in the Department's Audit Report Workpaper, Page 12.

Applying the federal test factors to the instant case, the workers for whom Taxpayer did not remit withholding

tax were, with one exception (Individual Six, who was primarily a clerical employee, and Individual Nine, who was Taxpayer's president and for whom \$400 was not subjected to withholding), independent contractors.

For Individuals Two and Four, the individuals were contractors for a particular project and whose business was contracting. Based on the factors listed on the IRS Website, Taxpayer has provided sufficient information to conclude that these individuals were independent contractors.

For the remaining individuals (except Individuals Six, Nine, and Ten) the individuals were assigned an engineering or drafting project whenever they requested work from Taxpayer. Taxpayer's role was primarily assigning work to be done and a reasonable deadline. Taxpayer did not provide any of the items needed to complete the projects and further did not provide holiday, vacation, or other pay beyond that which was requested by the individual for hours actually worked. By contrast, Taxpayer offered holiday, vacation, and other benefits to the individuals acknowledged by Taxpayer to be its employees. Based on the factors listed on the IRS Website (including but not limited to those specifically listed in this paragraph), Taxpayer has provided sufficient information to conclude that these individuals were independent contractors.

For Individual Ten, the individual was an accountant who worked from home. Further, the individual had multiple clients in addition to Taxpayer. Taxpayer did not control the time spent by Individual Ten working on Taxpayer's behalf, did not provide the individual the necessary items for completion of duties, and did not (other than a minimal Christmas bonus) provide any holiday, vacation, or other pay beyond that which was based on the individual's hours actually worked. Based on the factors listed on the IRS Website (including but not limited to those specifically listed in this paragraph), Taxpayer has provided sufficient information to conclude that this individual was an independent contractor.

Therefore, Taxpayer was not responsible for collecting withholding taxes for the years in question on the individuals designated in the Department's audit, with the exceptions of Individuals Six and Nine.

#### **FINDING**

Individuals Six and Nine are employees. The protest of taxes related to these individuals is denied. All other individuals are independent contractors. The protest of taxes related to these individuals is sustained.

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